

1 February 2008



Mr John Tamblyn
Chairman
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Dear Mr Tamblyn

Response to Total Environment Centre Rule Change Proposal: Demand Management and Transmission Networks

ENERGEX welcomes the opportunity to respond to Total Environment Centre's (TEC) Rule change proposal on demand management.

Please find attached ENEREX's submission regarding TEC's Rule change proposal. The Rule change proposal directly addressed Transmission Network Service Providers (TNSPs) with the intention that the same principles will apply to Distribution Network Service Providers (DNSPs) with a future Rule change proposal to address the deficiencies in the newly drafted distribution Rules. ENEREX's comments are provided from the point of view of a DNSP.

ENERGEX is well aware of the importance of demand management initiatives. Currently, ENEREX is actively pursuing further opportunities for demand management solutions to support its supply side initiatives. However, ENEREX considers that a number of issues on this matter require clarification and further consultation would be necessary before any changes could be progressed.

Should you have any queries regarding ENEREX's submission please do not hesitate to contact Rachel Leaver – Network Regulation Manager on (07) 3405 2924.

Yours sincerely

A handwritten signature in black ink, appearing to read "L. Dwyer", written over a horizontal line.

Louise Dwyer
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RESPONSE TO
THE AUSTRALIAN ENERGY MARKET COMMISSION
RULE CHANGE PROPOSAL
DEMAND MANAGEMENT AND TRANSMISSION
NETWORKS

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positive energy

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1. INTRODUCTION

1.1 Background

On 6 November 2007, Total Environment Centre (TEC) requested the making of the proposed *National Electricity Amendment (Demand Management) Rule 2007*. The Rule change proposal relates to the application of demand management to transmission networks.

The Rule proposal directly addresses Transmission Network Service Providers (TNSPs) with the intention that the same principles will apply to Distribution Network Service Providers (DNSPs) with a future Rule change proposal to address the deficiencies in the newly drafted distribution Rules.

ENERGEX's response to this Rule change proposal is from the point of view of a DNSP.

1.2 General Comments

ENERGEX is pleased to provide this submission in response to the TEC Rule change proposal. ENEREX strongly considers that further consultation and consideration on the proposed wording of the Rule change is required.

ENERGEX is well aware of the importance of demand management initiatives. Currently, ENEREX is actively pursuing further opportunities for demand management solutions to support its supply side initiatives and publishes such details in its Annual Network Management Plan (ANMP). However, it is ENEREX's position that attention needs to be focused on the risk / reward imbalance that is inherent in the current regulatory framework in the treatment of demand management options.

ENERGEX believes that the primary focus for the AEMC in any Rule change process is to ensure that adequate incentives exist through reforms to current policy and the regulatory framework, so Network Service Providers (NSPs) are not penalised for implementing demand management solutions.

ENERGEX believes that the *National Electricity Rules* (Rules) should ensure that a balanced approach is adopted by Network Service Providers (NSPs) in network planning so that both supply side and demand side options are considered on an equal footing where practical.

As the AEMC would be aware, reliability characteristics of augmentation are known. However, reliability outcomes for some demand management solutions are uncertain and may therefore expose NSPs to service quality penalties. ENEREX submits that cost-effectiveness should not be the only consideration in network planning, but rather the successful solution should deliver customer satisfaction as well as reliability of supply.

Another concern for ENERGEX is that the term, 'demand management' used by TEC in its proposal, is unclear. TEC is proposing that 'demand management' includes all of demand response, demand side management, demand side response, energy efficiency and non-network solutions. ENERGEX submits that this broad categorization fails to address which of these options are the most practical solutions to network constraint problems.

Finally, ENERGEX notes and supports its obligation under s.42(d) of the *Electricity Act (Qld)* 1994, which states that, as a condition of being a distribution authority, ENERGEX must consider both demand side and supply side options to provide, as far as technically and economically practicable, for the efficient supply of electrical energy.

2. RESPONSE TO RULE CHANGE PROPOSAL

2.1 Network Planning

- ***ENERGEX submits that demand side and supply side options should be considered concurrently.***

TEC's proposal suggests that demand side options should be examined initially followed by supply side alternatives. ENERGEX submits that this process is flawed. Demand side and supply side options should be considered concurrently when addressing network constraints where practical.

Network business planning puts together potential network options to deliver a supply system that meets relevant network reliability, safety and security needs. There are two options to deliver safe and secure supply:

1. Demand is managed by reducing the load; or
2. Investing in increased capacity in the network to meet the forecast demand.

Deciding which option is appropriate is not simply a matter of choosing the least cost option. The reliability characteristics of the demand management options must be akin to the firmness of the supply side alternative.

2.2 Annual Planning Reports

- ***ENERGEX submits that the AER should prepare guidelines that contain the reporting requirements on demand management.***

In accordance with the *Electricity Industry Code*¹, ENERGEX publishes an ANMP, which details how ENERGEX will manage and develop its supply

¹ *Electricity Industry Code QLD (2007) 3rd Edition.*

network to deliver an adequate, economic, reliable and safe connection and supply of electricity to its customers over the next five years.

Similar to other distribution utilities around Australia, ENERGEX is exploring Network Demand Management (NDM) as an adjunct to supply side management. ENERGEX is conducting a number of NDM activities that are detailed in the 2006/07 ANMP.

With regard to the level of detail that should be published, particularly in relation to future constraints, ENERGEX would have concerns publishing data with a high degree of uncertainty which may subsequently be relied upon for demand side management proposals. For example, data based on long range forecasts with a probability of change.

ENERGEX submits that the AER should be required to prepare guidelines that include the reporting requirements on demand management. This is a preferred approach to including such detailed reporting regulatory requirements in the Rules. The Rules should provide some guidance on these reporting requirements.

2.3 Demand Management Incentive

- ***ENERGEX supports an incentive scheme that rewards rather than imposes penalties for implementation of efficient non-network solutions.***

Clause 6.6.3 of the National Electricity Rules already provides, but does not require the AER to develop and publish a demand management incentive scheme to provide incentives for DNSPs to implement efficient non-network alternatives.

ENERGEX suggests that the AEMC also consider international models such as California's Decoupling "Plus" incentive scheme. In 2007, the California Public Utilities Commission (CPUC) approved an innovative plan that established incentives of sufficient level to generate comparable earnings for investor-owned utilities (IOUs) when they invest in cost-efficient energy efficiency methods. It offered a way for utilities to view their energy efficiency as a core part of their operations and capable of producing meaningful revenue.

Incentive schemes should also look beyond single regulatory determination periods.

2.4 Financial Cover for Demand Management Investments

- ***ENERGEX supports the proposed changes that will allow demand management costs to be recognised in a similar manner to network solutions.***

The current regulatory framework promotes significant disincentives for networks to implement demand side solutions. ENERGEX supports changes that will allow demand management costs to be recognised in a similar manner to network solutions.

The Rules need to recognise a mechanism to allow the recovery of forgone revenue of networks resulting from implementing demand side solutions. This is equally applicable for networks under a price cap or revenue cap form of regulation.

Demand management projects can involve costs, both in setting up the project and in the ongoing maintenance, particularly where there are a large number of customers involved. The regulatory framework needs to acknowledge these costs in an appropriate manner. Because capital and operating expenses are treated differently, appropriate incentives need to be put in place to pursue demand side solutions.

ENERGEX supports any Rule changes that will recognise efficient demand management costs incurred by NSPs. A balanced approach would allow businesses to be compensated where operating costs replaced capital costs.

2.5 Revenue Determinations

- ***If demand management activities are to be prioritised and integrated into revenue determinations there should be mechanisms introduced to balance the risks faced by NSPs when they invest in non-network solutions.***

The incentivised regulatory framework needs to be put in place first.

Any policy decision to prioritise demand management contains an implicit understanding or acceptance that there may be an increase in outages due to the differing reliability characteristics of demand management options. Such risks to reliability and service quality need to be understood and recognised by the Regulator.

2.6 Acknowledgement of Modest Demand Management Expenditure

- ***ENERGEX agrees with this proposal.***

ENERGEX agrees with this proposal but notes that the principles and arguments made under 2.3, 2.4 and 2.5 above equally apply.

Further, as opposed to "modest" activities, there are many initiatives that network businesses undertake that provide long term demand management benefits. An example of this is domestic controlled loads. The regulatory framework needs to also recognise and provide incentives to network businesses in this regard.

2.7 Effective Prudency Reviews

- ***ENERGEX submits that network service providers are the appropriate 'experts' when assessing the efficient level of network demand investment.***

TEC proposes that past and projected capital expenditure should be reviewed by 'experts' with a demonstrated balanced understanding of the theory and practice of demand management'.²

DNSPs, through their direct connection to the customer, are in a unique position to identify demand management opportunities and deliver demand management solutions. ENEREX submits that NSPs have service quality obligations and the onus is on the NSP to deliver safe and reliable supply to customers. To this effect, ENEREX submits that NSPs are the appropriate 'experts' when assessing the efficient level of demand management investment required to deliver safe and reliable supply to its customers. As TEC have recognised, the market is still questionable whether such experts, as noted in the paper, are readily available.

2.8 Regulatory Test

- ***ENERGEX submits that there is an existing Regulatory Test framework in place that recognises this and;***
- ***ENERGEX submits that cost should not be the only consideration in determining the most appropriate option.***

ENERGEX does not agree with TEC's proposal that demand side solutions be prioritised above other options. ENEREX submits that cost effectiveness should not be the only consideration in determining the most appropriate solution when conducting a regulatory test assessment.

NSPs have minimum service standards that they are required to meet and demand management solutions should meet reliability expectations of

² At page 38 of TEC submission.

customers. In this respect, the costs and benefits of demand side and supply side options should be considered in parallel rather than separately.

Any changes to the current regulatory test should not be considered as part of this consultation but rather in a broader context.

2.9 Short and Long Term Price for Demand Management

- ***ENERGEX submits that this proposal is out of context.***

ENERGEX submits that this proposal is out of context and does not appear to acknowledge the manner in which the wholesale pricing and ancillary services markets have already been established to incentivise demand response.

3. CONCLUSION

ENERGEX is actively engaged in demand management and generally supports the principles behind the TEC proposal. However, the Rules currently provide discretion on the AER to develop and publish a demand management incentive scheme to provide DNSPs with incentives to implement efficient non-network alternatives. Any further changes to the Rules that impose on NSPs further obligations regarding demand management must ensure that the cost of compliance is outweighed by the benefits to the market. It is important that costs are recognised by the regulatory framework.

ENERGEX also submits that NSPs are currently in the best position to identify and implement efficient and effective demand management solutions and that when undertaking network planning, both supply side and demand side options must be considered concurrently where practical. Whatever solution is eventually implemented, it must not only cost-effective but also ensure that customer satisfaction and reliability of supply are maintained.